Supreme Court, U.S.
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No. 96-881

In the Supreme Court of the United States

OCTOBER TERM, 1996

DONALD AND MADELAINE TAFFI, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether, when a debtor in a bankruptcy case is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be valued under Section 506(a) of the Bankruptcy Code at (i) the amount the creditor would realize from a hypothetical foreclosure sale of the property or (ii) the fair market value of the property in the hands of the debtor.

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OPINIONS BELOW

The opinion of the court of appeals on rehearing en banc (Pet. App. 1-7) is reported at 96 F.3d 1190. The panel opinion of the court of appeals (Pet. App. 8-23) is reported at 68 F.3d 306. The opinion of the district court (Pet. App. 24-34) is reported at 72 A.F.T.R.2d 93-6607. The opinion of the bankruptcy court (Pet. App. 35-60) is reported at 144 B.R. 105.

JURISDICTION

The judgment of the court of appeals was entered on September 17, 1996. The petition for a writ of certiorari was filed on October 31, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT

1. In 1991, petitioners Donald and Madelaine Taffi filed for bankruptcy under Chapter 11 of the Bankruptcy Code (Pet. App. 39). Prior to the bankruptcy filing, the Internal Revenue Service made an assessment against petitioners for 1980 and 1981 taxes in the amount of $496,940, and a notice of federal tax lien had been filed for that amount (*id.* at 38). That tax lien attached to the debtors' personal residence and to approximately $10,000 in personal property (*ibid.*).

Petitioners proposed a bankruptcy plan under which they would retain their house and continue to live in it (Pet. App. 45). The parties to the bankruptcy proceeding stipulated that, under normal market conditions, the house would sell for $300,000 and, after

selling costs of 9 percent were deducted, would clear $273,000 (*id.* at 38-39). The parties further stipulated, however, that the house would clear only $240,000 in a forced or liquidation sale (*id.* at 39). Because liens on the house that were senior to the tax lien totaled $233,942.38 (*id.* at 38), the government would thus realize $66,058 in a normal or fair market value sale of the house (or $39,058 after selling costs were deducted) but would realize only $6,058 in a forced sale.

Under the bankruptcy plan submitted by petitioners, they proposed to retain their house and to value the government's secured tax claim at the amount that would be realized from a forced sale of the house (plus $10,000 for the personal property to which the tax lien had also attached). The plan proposed by petitioners was a "cramdown" plan, under which the debtor seeks confirmation of a plan despite a creditor's objections. In a "cramdown" plan, the amount of a secured claim is reduced to an "allowed secur ed claim" under the valuation provisions of Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a).[1] The portion of the secured claim that is not treated as an "allowed secured claim" under that provision is treated as an unsecured claim. *Ibid.*

The bankruptcy court approved both the plan and the valuation of the allowed secured tax claim that petitioners proposed (Pet. App. 46). The district court, however, reversed the determination of the value of the allowed secured tax claim (*id.* at 24-34). The district court held that, because the plan allowed the debtors to retain the house, the "allowed secured amount" of the federal tax claim is the fair market

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[1] The creditor retains a lien to protect its secured claim. 11 U.S.C. 1129(b). See also 11 U.S.C. 1325(a)(5)(B)(i), (ii).

value of the house without any deduction for selling costs (*id.* at 32-33).

2. A panel of the Ninth Circuit affirmed. The panel opinion agreed with the district court that, when the debtor is permitted to retain the property to which the creditor's lien has attached, the proper measure of the "allowed secured claim" is the fair market value of the property. The court concluded that Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), does not authorize the deduction of hypothetical foreclosure costs when the property will not in fact be sold at a foreclosure (Pet. App. 16-17).

3. On rehearing en banc, the court of appeals agreed with the panel decision. The en banc court held that, when the debtor retains the collateral that secures the creditor's secured claim, the amount of the "allowed secured claim" under Section 506(a) is not the amount that the creditor would obtain in a hypothetical foreclosure sale of the collateral but is, instead, the "fair market value of what the debtors are using" (Pet. App. 5). The court noted that its interpretation of Section 506(a) conflicted with the en banc opinion of the Fifth Circuit in *Associates Commercial Corp.* v. *Rash*, 90 F.3d 1036 (1996), petition for cert. pending, No. 96-454, but was "in harmony with" prior decisions of the First, Fourth, Sixth and Eighth Circuits (Pet. App. 6).

ARGUMENT

As the court of appeals noted in its en banc decision (Pet. App. 6), there is a conflict among the circuits on the question presented in this case. The proper valuation of secured claims in the situation where the debtor is permitted to retain the collateral over the objection of the secured party is a frequently recur-

ring question of substantial importance. Resolution of this recurring question by this Court is needed to avoid repetitive and wasteful litigation and to ensure evenhanded treatment of debtors under the many federal programs that authorize or establish secured claims for the United States, as well as evenhanded treatment of debtors and secured creditors generally.

1. This case involves the proper valuation of a secured claim in a bankruptcy case when the debtor is permitted to retain the property that secures the claim. When, as in the present case, a debtor proposes to retain such property under a plan to which the creditor has objected, the court may approve the plan only if, among other requirements, the holder of the secured claim will receive at least the value of the "allowed amount" of the secured claim. 11 U.S.C. 1129(b)(2)(A)(i)(II). See also 11 U.S.C. 1325(a)(5)(B). The "allowed amount" of such a claim is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). H.R. Rep. No. 595, 95th Cong., 1st Sess. 415 (1977). That Section specifies that a secured claim is to be treated as an "allowed" secured claim only to the extent of "the value of such creditor's interest in the estate's interest in such property" (11 U.S.C. 506(a)). This statute further specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*). To the extent that the secured claim exceeds the value thus determined, it is treated as an unsecured claim (*ibid.*).

With the exception of the recent decision of the Fifth Circuit in *Associates Commercial Corp.* v. *Rash*, *supra*, all of the courts of appeals that have interpreted the valuation provisions of Section 506(a) have rejected using "foreclosure value" as the mea-

sure of value when the debtor retains the collateral. These courts include the Ninth Circuit in the present case (Pet. App. 6), the Eighth Circuit (*Metrobank* v. *Trimble*, 50 F.3d 530 (1995) (Chapter 13 case valuing pickup truck)), the First Circuit (*Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Institution for Savings*, 50 F.3d 72 (1995) (Chapter 11 case valuing real property used in business)), the Sixth Circuit (*Huntington National Bank* v. *Pees* (*In re McClurkin*), 31 F.3d 401 (1994) (Chapter 13 case valuing real property used as residence)) and the Fourth Circuit (*Brown and Company Securities Corp.* v. *Balbus*, 933 F.2d 246 (1991) (Chapter 13 case valuing real property); *Coker* v. *Sovran Equity Mortgage Corp.*, 973 F.2d 258 (1992) (same)).[2]

Less than two months before the Ninth Circuit issued its en banc opinion in this case, the Fifth Circuit, also sitting en banc, held (with six dissenting judges) that Section 506(a) permits the allowed amount of a secured claim to be reduced to the foreclosure value of the property securing that claim, even when the debtor retains the property. *Associates Commercial Corp.* v. *Rash*, 90 F.3d at 1060. In this case, however, the court of appeals expressly disagreed with the reasoning and conclusion of the Fifth Circuit's decision in *Associates Commercial*

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[2] Petitioners err in contending (Pet. 6 n.1) that *Winthrop*, *McClurkin* and *Coker* are not "in harmony" with the decision in this case. In each of those decisions, the court rejected the notion—also rejected by the Ninth Circuit in this case (Pet. App. 6)—that the value of a secured claim must be based on what the creditor would realize if it sold the collateral outside of bankruptcy. See 50 F.3d at 75; 31 F.3d at 405; 973 F.2d at 260.

Corp. (Pet. App. 6). The court stated in the present case that (*id.* at 5):

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. * * * Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using.

The conflict between the en banc decision of the Fifth Circuit in *Associates Commercial Corp.* and the decisions of the First, Fourth, Sixth, Eighth and Ninth Circuits is direct and irreconcilable. Unless resolved by this Court, this conflict will produce wasteful and repetitive litigation and will result in disparate treatment of secured claims in bankruptcies based solely on geographical happenstance.

2. a. The question presented in this case and in the pending petition in *Associates Commercial Corp.* is of substantial importance. As petitioners note (Pet. 5), approximately 300,000 bankruptcy cases were filed under Chapters 11 and 13 of the Bankruptcy Code in 1995. The Internal Revenue Service advises us that, during the year ending September 30, 1996, the Service filed proofs of claim in approximately 162,000 bankruptcy cases, asserting $329,830,957 in secured claims in Chapter 11 cases and $334,812,254 in secured claims in Chapter 13 cases.

The United States is also a secured creditor in a variety of other contexts. To list only a few examples, the United States may assert liens for payment of penalties under agricultural quota programs and for the repayment of agricultural loans (7 U.S.C. 1314(c), 1339(a)(1), 1340(4), 1927(c)), for repayment of advances made under defense contracts (10 U.S.C. 2307(d)), for payment of certain criminal fines (18 U.S.C. 3613(c)), for payment of customs duties (19 U.S.C. 198), for payment of a judgment lien in favor of the United States in a civil action (28 U.S.C. 3201(a)), for payment of pension benefits under the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1368(a)), for repayment of black lung benefits (30 U.S.C. 934(b)(2)), for repayment of advances made to a contractor by a government agency (41 U.S.C. 255(d)), for repayment of low-income housing loans (42 U.S.C. 1484(a)(5), 1487(d)(1)), for payment of the costs of removing or remediating hazardous substances (42 U.S.C. 9607(*l*)(1)) and for payment of charges due under a federal irrigation project (43 U.S.C. 542).

The United States is thus a secured creditor in a large portion of all Chapter 11 and Chapter 13 bankruptcy cases. If the secured claim of the government in these cases were reduced under the foreclosure valuation method advanced by petitioners and adopted by the Fifth Circuit in the *Associates Commercial Corp.* case, the loss of revenue to the Treasury would be substantial.

b. Because of the conflict among the circuits created by the decision in *Associates Commercial Corp.*, two taxpayers who owe the same amount of tax and possess assets of the same value ultimately may pay significantly different amounts of their federal tax liability depending solely upon the happenstance

of geography. This disparate treatment impedes the objective of "ensur[ing] as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). See also *Lyeth* v. *Hoey*, 305 U.S. 188, 193 (1938). It similarly prevents the uniform application of other federal programs that authorize or create secured claims for the government. Review by this Court is warranted to resolve the continuing conflict among the circuits on the recurring question presented in this case.

3. The question presented in this case and in *Associates Commercial Corp.* is, in our view, ultimately the same, although the issue arises in different contexts. In particular, *Associates Commercial Corp.* is a Chapter 13 case in which the collateral that the debtors propose to retain for their own use is personal property used in the debtors' business. The present case is a Chapter 11 case in which the collateral that the debtors propose to retain is the debtors' residence. To ensure that a decision on either of these two petitions resolves the underlying question in all relevant contexts, the Court may wish to consider granting both petitions and either consolidating them or setting the cases for argument in tandem. Alternatively, we would suggest that the Court grant the present petition and hold the petition in *Associates Commercial Corp.*, No. 96-454, pending its decision in this case.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted.

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